

MULTIMEDIA



UNIVERSITY

STUDENT ID NO

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MULTIMEDIA UNIVERSITY

FINAL EXAMINATION

TRIMESTER 2, 2019/2020

BBF2124 – FINANCIAL MANAGEMENT II
(All sections/Groups)

10 MARCH 2020
2.30p.m – 4.30p.m
(2 Hours)

INSTRUCTIONS TO STUDENT

1. This Question paper consists of 3 pages with 4 questions only.
2. Answer all the 4 questions
3. Please write all your answers in the Answer Booklet provided.

QUESTION 1

- a) Whirlpool's Corporation has asked its financial manager to determine its optimal capital structure, which is composed of the following sources and target market value proportions, the firm is in the 40 percent tax bracket.

Sources of Capital	Target Market Proportions
Long-term debt	30%
Preferred stock	5%
Common stock equity	65%

Debt: The firm can raise debt by selling a 20-year, RM1,000 par value, 9 percent coupon interest rate bond for RM980. A flotation cost of 2 percent of the par value would be required in addition to an average discount of RM20 per bond.

Preferred Stock: The firm has determined to issue preferred stock at RM85 per share. The stock will pay a RM6.50 annual dividend. The cost of issuing and selling the preferred stock is expected to be RM3 per share.

Common Stock: The firm's common stock is currently selling for RM55 per share. The dividend expected to be paid at the end of the coming year is RM4.80. Its dividend payments have been growing at a constant rate for the last four years. Four years ago, the dividend was RM3.45. It is expected that a new common stock issue must be underpriced at RM2 per share and the firm must pay RM1 per share in flotation costs.

- (i) Measure the both before and after-tax cost of debt. (5 marks)
 - (ii) Measure the cost of preferred stock. (3 marks)
 - (iii) Measure the cost of new common stock. (6 marks)
 - (iv) Calculate the weighted average cost of capital assuming the firm has exhausted all retained earnings. (4 marks)
- b) Briefly discuss why cost of capital plays a significant role in the long-term investment decision. Explain how capital budgeting decision is related to the firm's goal of maximizing shareholder's wealth. (7 marks)

(Total: 25 marks)

Continued ...

QUESTION 2

- a) Bugg Manufacturing makes the wooden chairs that are selling for RM5 per chair. Fixed operating costs are RM45,000 per year, while variable costs are RM2.80 per chair. The manufacturer pays annually of RM9,000 interest on long-term debt and RM7,000 of preferred dividends. At this point, the manufacturer is selling 30,000 wooded chairs per year and is taxed at a rate of 40 percent.
- (i) Calculate the operating breakeven point in units. (2 marks)
 - (ii) Calculate the firm's earnings before interest & tax and earnings available for common on the basis of the firm's current sales of 30,000 units. (5 marks)
 - (iii) Calculate the degree of operating leverage (DOL). (5 marks)
 - (iv) Calculate the degree of financial leverage (DFL). (5 marks)
 - (v) Calculate the degree of total leverage (DTL). (2 marks)
- b) Briefly discuss how the asymmetric information influence the decision made by firm's manager on the firm's capital structure? (6 marks)
- (Total: 25 marks)

QUESTION 3

- a) Nathan holds the shares of Marc.Com Corporation. The board of directors of the Marc.Com is considering increasing the number of common shares. The board is voting for either a 30 percent stock dividend or a 4-for-1 stock split. The current stock price is RM15 per share, while the earning per share is RM2.80, and dividend per share is RM1.50. Currently, the stockholder's equity account is as follows:

Preferred stock	RM100,000
Common stock (50,000 shares at RM2 par)	RM100,000
Paid-in capital in excess of par	RM400,000
Retained earnings	RM300,000
Total stockholder's equity	RM900,000

Continued ...

- (i) Show the effect on the *equity accounts* and *earning per-share* of a 30 percent stock dividend. (6 marks)
 - (ii) Show the effect on the *equity accounts* and *earning per share* of a 4-for-1 stock split. (4 marks)
 - (iii) Show the effect on the *equity accounts* of a 1-for-4 reverse stock split. (6 marks)
 - (iv) Give a suggestion to Marc.Com on which option is going to accomplish its firm's goal of reducing the current stock price while maintaining a stable level of retained earnings. (3 marks)
- b) Briefly discuss whether the approach of the residual theory of dividends will lead to a stable dividend. Does this theory support the dividend relevance theory? (6 marks)

(Total: 25 marks)

QUESTION 4

- a) Your father is interested to invest in a RM1,000 par value corporate bond which paying 12 percent coupon interest rate semi-annually. The bond has 20 years until maturity. The bond has 13 warrant attached for the purchase of common stock. The theoretical value of each warrant is RM15. The market price of the common stock is RM35 per shares. The interest rate on an equal-risk straight bond is currently 14 percent.
- (i) Calculate the straight bond value. (5 marks)
 - (ii) Calculate the implied price of *each* warrant attached to the bond. (6 marks)
 - (iii) Based on the theoretical value of the bond and the implied prices, would you recommend your father to invest in this bond. Explain. (2 marks)
 - (iv) Assume this is a convertible bond that can be converted into 30 shares of common stock. Calculate the conversion (or stock) value of the bond. (3 marks)
- b) Explain financial lease with an example. How is the financial lease similar to long-term debt. (9 marks)

(Total: 25 marks)

End of Paper